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PAGE 01 ROME 10230 01 OF 02 211753Z

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FM AMEMBASSY ROME

TO SECSTATE WASHDC 5428

TREASURY DEPT WASH DC

AMEMBASSY BERN

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY PARIS

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AMCONSGEN MILAN

AMCONGEN NAPLES

LIMITED OFFICIAL USE SECTION 1 OF 2 ROME 10230

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TAGS: EFIN, IT

SUBJECT: ITALIAN FINANCIAL MARKET DEVELOPMENTS (77-1)

REF: STATE 138822

1. BACKGROUND. PER REQUEST REFTEL, EMBASSY HEREBY RECOMMENCES BI-WEEKLY REPORTS ON ITALIAN FINANCIAL MARKET DEVELOPMENTS. REPORT WILL CONTAIN SUMMARY BI-WEEKLY MONETARY MOVEMENTS STATISTICS RECEIVED FROM ITALIAN EXCHANGE OFFICE THROUGH BANK
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PAGE 02 ROME 10230 01 OF 02 211753Z

OF ITALY (BOI) CHANNEL, SOME ADDITIONAL FINANCIAL MARKET-STATISTICS, AND EMBASSY COMMENTARY. BECAUSE OF CHANGE IN ORGANIZATIONAL STRUCTURE OF BOI, EMBASSY MAY NOT IN EVERY INSTANCE BE ABLE TO TOUCH BASE WITH APPROPRIATE BOI OFFICIALS EVERY TWO WEEKS.

2. MONETARY MOVEMENTS. TABLE 1 PRESENTS SUMMARY DATA

FOR THE MONTH OF MAY AND FOR FIVE-MONTH PERIOD, FOR MONETARY MOVEMENTS, INCLUDING PRELIMINARY MEASUREMENT OF OVERALL BALANCE OF PAYMENTS SURPLUS OR DEFICIT. TABLE 2 SHOWS ITALY'S FOREIGN RESERVE POSITION, INCLUDING BOI CONVERTIBLE FOREIGN EXCHANGE RESERVES AND NET FOREIGN POSITION OF COMMERCIAL BANKS. TABLE 3 LISTS SOME EXTRAORDINARY FOREIGN EXCHANGE TRANSACTIONS WHICH OCCURRED DURING THE MONTH AND DURING THE ENTIRE PERIOD TO DATE. 3. MOST INTERESTING DEVELOPMENTS SHOWN IN DATA FOR MONTH OF MAY (TABLE 1) ARE VERY MODEST OVERALL BALANCE OF PAYMENTS DEFICIT OF \$160 MILLION AND CONTINUED LARGE INCREASE/(1.2 BILLION) IN NET SHORT-TERM FOREIGN LIABILITIES OF COMMERCIAL BANKS. NOTE, HOWEVER, THAT IN MAY VIRTUALLY ENTIRE INCREASE IN NET FOREIGN DEBTS OF COMMERCIAL BANKS WAS REFLECTED IN CORRESPONDING RISE IN CONVERTIBLE CURRENCY HOLDINGS IN BOI. THIS PATTERN IS MORE ENCOURAGING THAN THAT FOR PREVIOUS FOR MONTHS, WHEN THERE WAS NO CORRESPONDING RISE IN BOI CONVERTIBLE CURRENCY HOLDINGS AS POTENTIAL OFFSET TO RISING NET FOREIGN DEBT OF COMMERCIAL BANKS. TABLE 1 ALSO SHOWS THAT OVERALL BALANCE OF PAYMENTS DEFICIT FOR FIRST FIVE MONTHS WAS ABOUT 2.3 BILLION. THIS IS SOMEWHAT MORE FAVORABLE OUTCOME THAN EMBASSY HAS FORECAST (I.E., DEFICIT OF ABOUT 2.3 BILLION FOR ENTIRE FIRST HALF). IN FACT, VERY SMALL DEFICIT IN MAY AND PATTERN OF EXCHANGE MARKET INTERVENTION SO FAR IN JUNE SUGGEST LIMITED OFFICIAL USE

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PAGE 03 ROME 10230 01 OF 02 211753Z

THAT FIRST HALF DEFICIT MAY BE LOWER THAN 2.3 BILLION.

R. TABLE 2 SHOWS ITALY'S NET FOREIGN RESERVE POSITION AS OF END OF 1976 AND END-MAY 1977. MOST INTERESTING ASPECTS OF TABLE ARE COMPARISON OF BOI CONVERTIBLE FOREIGN EXCHANGE ASSETS AND NET FOREIGN DEBT OF COMMERCIAL BANKS. AT END 1976, THESE TWO FIGURES WERE ALMOST THE SAME. AT END-MAY, BANK'S NET FOREIGN DEBT EXCEEDED BOI CONVERTIBLE FOREIGN EXCHANGE BY ABOUT \$2 BILLION (\$6.3 BILLION VS \$4.3 BILLION). THERE HAS BEEN MUCH DEBATE IN ITALIAN PRESS ABOUT WHETHER OR NOT SHARP RISE IN COMMERCIAL BANKS' NET FOREIGN DEBT PRESENTS SERIOUS PROBLEM. EMBASSY BELIEVES THAT THERE IS POTENTIAL PROBLEM IF UNFORESEEN POLITICAL OR ECONOMIC DEVELOPMENT SHOULD DISTURB EXCHANGE MARKET. HOWEVER, THERE ARE SOME COMFORTING CONSIDERATIONS, ESPECIALLY: 1) BOI CONVERTIBLE FOREIGN EXCHANGE COULD PERHAPS BE DRAWN BY \$2.8 BILLION TO 1.5 BILLION LEVEL WITHOUT SERIOUS PSYCHOLOGICAL CONSEQUENCES, AND 2) SEASONALLY STRONG THIRD QUARTER MAY WELL GENERATE BALANCE OF PAYMENTS SURPLUS OF AS MUCH AS \$1 BILLION, FURTHER BOOSTING SUCH BOI CONVERTIBLE EXCHANGE HOLDINGS

TABLE 3 SHOWS LIST OF SOME EXTRAORDINARY
FOREIGN EXCHANGE TRANSACTIONS IN MAY AND IN FIRST FIVE
MONTHS OF 1977. FIAT/LIBYA ITEM CONCERNS PURCHASE BY
LIBYAN GOVERNMENT OF PART OWNERSHIP OF FIAT. GOLD
REVALUATION ITEM IS RESULT OF BOI DECISION TO RE-VALUE
OFFICIAL GOLD HOLDINGS ON QUARTERLY BASIS. THIS
INCREASES GROSS OFFICIAL RESERVES, BUT NOT NET OFFICIAL
RESERVES, EQUAL OFFSETTING SINCE CONTINGENT LIABILITY
IS CREATED. ITEM SHOWING DRAWING OF \$104 BILLION FROM
BUNDESBANK LOAN IS RESULT OF DECISION BY BOI TO INCREASE
FOREIGN CURRENCY DEBT TO BUNDESBANK RATHER THAN
WITHDRAWING PART OF BOI'S GOLD COLLATERAL ON LAST
OCCASION WHEN QUARTERLY ADJUSTMENT WAS MADE TO REFLECT
CHANGE IN FEE MARKET GOLD PRICE. IMF STANDBY
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PAGE 04 ROME 10230 01 OF 02 211753Z

DRAWING CONSISTS OF SDR 90 MILLION FIRST TRANCHE DRAWING
UNDER SDR 450 MILLION STANDBY AGREEMENT APPROVED BY
IMF BOARD ON APRIL 25. EUROMARKET LOAN ITEM CONSISTS
OF PREPAYMENTS ON GROUP OF EUROMARKET TERM LOANS RECEIVED
BY NUMBER OF STATE-OWNED CREDIT INSTITUTES AND OTHER STATE ENTITIES
FOR COMPENSATORY (I.E., BALANCE OF PAYMENTS) FINANCING
PURPOSES IN PERIOD JUNE 1972 TO DATE.

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PAGE 01 ROME 10230 02 OF 02 211759Z
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LIMITED OFFICIAL USE SECTION 2 OF 2 ROME 10230

5. OTHER FINANCIAL MARKET DEVELOPMENTS. TABLE 4 SHOWS SOME KEY EXCHANGE RATE AND INTEREST RATE VARIABLES AS OF JUNE 20, 1977. MAIN POINTS OF INTEREST ARE:
 STABILITY OF LIRA/ DOLLAR SPOT RATE, CONTINUED SLIGHT STRENGTHENING OF THREE-MONTH FORWARD RATE, STRONGER LIRA IN BLACK MARKET THAN IN OFFICIAL SPOT MARKET, STABILITY IN BOI WEIGHTED AVERAGE DEPRECIATION INDICES, AND CONTINUED SLIGHT DECLINE IN BOTH 48-HOUR AND 3-MONTH INTERBANK INTEREST RATES FOLLOWING RECENT 2-POINT CUT IN DISCOUNT RATE FROM 15 PERCENT TO 13PERCENT.

TABLE 1-MONETARY MOVEMENTS(MILLIONS OF DOLLARS)

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PAGE 02 ROME 10230 02 OF 02 211759Z

MAY 1-31 JAN 1 TO MAY 31

1. BOI/UIC:

GOLD	-	862.41)
CONVERT. FOR.EXCH.	1,165.9	1,053.1
TOTAL BOI/UIC	1,029E	992I
2. COMM BANKS' NET FOR. POS	1,188.6	3,327.1
SUB-TOTAL	159.3	2,334.3
3. FOR. EXCHANGE ADJUST. (APPROX)	0.7	9.3
4. BOP SURPLUS:DEFICIT	160.0	2,325.0

1) INCLUDES GOLD REVALUTATION OF \$853.7 SHOWN AS SIMULTANEOUS RISE IN GOLD ASSETS AND CORRESPONDING CREATION OF EQUAL CONTINGENT LIABILITY. LATTER IS INCLUDING "OTHER".

TABLE 2

FOREIGN RESERVE POSITION (MILLIONS OF DOLLARS)

12/33/76 5/31/77

1. BOI/UIC

GOLD	9,320.5	10,182.9
CONVERT. FOR. EXCH.	3,132.0	4,315.5
OTHER (INCL. GOLD REVAL.LIRE)	12,372.0	-13,425.1
TOTAL BOI/UIC	80.5	1,073.3

2. COMM/BANKS NET FOR.POS. 3,011.0 6,338.1

TOTAL -2,930T 5,264.8

1)INCLUDES LIABILITIES TO EC, BUNDESBANK AND IMF.

TABLE 3- EXTRAORDINARY TRANSACTIONS (MILLIONS OF DAOOARS)

	MAY 1-31	JAN 1-MAY 1
FIAT/LIBYA	-	306.0
GOLD REVALUATIONS	-	853.7
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PAGE 03 ROME 10230 02 OF 02 211759Z

BUNDESBANK LOAN	-	104.0
IMF STANDBY (1977)	014.0	104.0
EUROMARKET LOANS	83.3	200.0

10. TABLE 4- FINANCIAL MARKET RATES

	6/20/77
LIRA/DOLLAR FX RATE: SPOT	885.00
3 MOS. FORWARD	903.75
BLK MKT.	879.00

BOI FX INDEX 1) ALL CURRENCIES	37.62
DOLLAR	34.35

INTER-BANK INTEREST RATES: 48-HOUR	13.875
3 MOS.	14.375

1) WEIGHTED AVERAGE PERCENT DEPRECIATION SINCE 2/9/73

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